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John Wright

February 7, 1978

The Honorable C.W. "Bill" Lewis
Arizona State Representative
4426 North 63 Avenue
Phoenix, Arizona 85033

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ARIZONA ATTORNEY GENERAL

Re: 78- 21 (R77-252)

Dear Mr. Lewis:

You have requested an opinion as to the effect of 1977 legislation exempting solar energy devices from transaction privilege tax. Specifically, you are concerned with whether a contractor is entitled to claim an exemption from the tax pursuant to A.R.S. § 42-1312.01(A)(9).

A contractor is, in effect, a middleman. The contractor purchases tangible personal property for incorporation into a structure from a retailer, and sells the completed structure to the purchaser. Thus the contractor is involved in two potentially taxable transactions under the transaction privilege tax statutes, A.R.S. §§ 42-1301, et seq.

The Legislature has chosen to exempt from the transaction privilege tax sales of tangible personal property made by a retailer to a contractor. A.R.S. § 42-1321.A. provides for this exemption as follows:

A. This article shall not apply to:

.

3. Sales of tangible personal property to a person licensed as a contractor under chapter 10 of Title 32 who holds a valid privilege tax license for engaging or continuing in the business of contracting under this article when the tangible personal property so sold is incorporate or fabricated by the contractor into any structure, project, development or improvement in fulfillment of a contract therefor

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The tax is not imposed on the retailer and therefore no economic burden exists to be passed on to the contractor. A solar energy device sold by a retailer to a licensed contractor for incorporation into a structure is thus exempt from the tax imposed upon the retailer by A.R.S. § 42-1312.

The second transaction the contractor is involved in concerns the sale of the structure to the purchaser. The taxable event here is the privilege of engaging in the business of contracting. There is no solar energy device exemption granted in this transaction, nor is a deduction from the contractor's gross income provided. Chapter 152, Section 14, of the 1977 Session Laws amended A.R.S. § 42-1312.01 to provide:

A. In addition to the exemptions prescribed by the terms of § 42-1312, the following categories shall also be exempt:

* * *

9. Solar energy devices. . . .

* * *

(Emphasis supplied.)

A.R.S. § 42-1312 provides for certain exemptions from the transaction privilege tax imposed upon sales of tangible personal property at retail by a vendor of tangible personal property. The exemptions created under A.R.S. § 42-1312 cannot be extended to a contractor, for he is not engaged in the business of selling tangible personal property at retail. Duhamel v. State Tax Commission, 65 Ariz. 268, 179 P.2d 252 (1947).

Thus, the central issue to be resolved is whether the exemptive language of A.R.S. § 42-1312.01 may be asserted only by retailers of tangible personal property otherwise taxable under A.R.S. § 42-1312 or whether any other person or entity subject to the transaction privilege tax -- be it a mining company, a lessor of property or a contractor -- may claim the benefits of the exemptions to create a deduction from his own (as opposed to his vendor's) tax base.

The answer to this question is contained in Arizona State Tax Commission v. Lawrence Manufacturing Co., 15 Ariz. App. 486, 489 P.2d 860 (1971). It was there held that A.R.S. § 42-1312.01 created exemptions upon the sale of items of

tangible personal property by retailers and that the statute (specifically, subsection (A)(2) thereof) did not create an exemption from the tax base of a lessor of mining equipment. The Court stated, 15 Ariz. App. at 489:

The plaintiff contends that rental income from mining equipment was exempted by A.R.S. § 42-1312.01, subsec. A, par. 2 during the period in question. Section 42-1312.01 simply adds certain "categories" to the exemptions provided under A.R.S. § 42-1312, as amended. The gist of § 42-1312 is that the tax levied by A.R.S. § 42-1309, as amended, was imposed on "every person engaging or continuing within this state in the business of selling any tangible personal property whatever at retail * * *." (Emphasis added.) There are enumerated exceptions in § 42-1312 to which § 42-1312.01 added other exceptions. The exempting language of A.R.S. § 42-1312 exempts "the gross proceeds of sales or gross income from [certain activities] * * *." This language leads us to the conclusion that the tax and the exemption plaintiff seeks to apply to itself is a tax on, and an exemption of, businesses selling tangible personal property. The tax on plaintiff's business activity, that of leasing the equipment involved, as is alleged in this case, is imposed by A.R.S. § 42-1314, as amended, supra. On the logic that an exception can be no broader than the general, plaintiff's argument here fails. An exemption of the business of selling mining paraphernalia at retail cannot exempt rental income, where it is not shown in the record that plaintiff was in the business of selling mining equipment (it was not so alleged in either complaint and there was no proof below). On the contrary, it must be presumed that plaintiff is in the business of renting from the fact of the single rental transaction alleged and admitted below.

(Emphasis added.)

The same reasoning applies here. A contractor, like the lessor of mining equipment, is not engaged in the business of selling tangible personal property. Duham v. State Tax Commission, supra. Since the exemptions under A.R.S. § 42-1312.01 were created for the benefit of persons engaged only in the business of selling such property at retail (taxable under A.R.S. § 42-1312), a contractor cannot claim its benefits to deduct the costs of solar energy devices from his own tax base.

The transaction privilege tax is levied upon contracting activity not under A.R.S. § 42-1312, but rather under A.R.S. § 42-1310(2)(i) as follows:

* * *

2. At an amount equal to one percent of the gross proceeds of sales or gross income from the business upon every person engaging or continuing within this State in the following businesses:

* * *

(i) Contracting, but the sale price of land which shall not exceed the fair market value and the payments paid by the contractor for labor employed in construction, improvements or repairs shall not be subject to such tax.

Furthermore, A.R.S. § 42-1301(5) defines "gross income" as being the ". . . gross receipts of a taxpayer derived from trade, business, commerce or sales. . . ." A.R.S. § 42-1301(8) in turn defines "gross receipts" as including

. . . the total amount of the sale, lease or rental price . . . of the retail sales of retailers, including all receipts, cash, credits and property of every kind or nature, and any amount for which credit is allowed by the seller to the purchaser without any deduction therefrom on account of the cost of the property sold, materials used, labor or service performed, interest paid, losses, or any other expense. . . .

(Emphasis added.)

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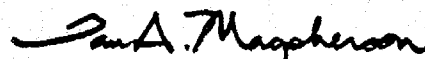
Thus, even if a contractor were considered to be a retailer of tangible personal property, he could not deduct from his gross receipts the acquisition costs of the property sold or materials used. As a contractor, however, he is allowed a deduction from his gross income for labor employed and for the cost of land. Since the exemptions provided for in A.R.S. § 42-1312.01 do not relate to or add to the above provision, (i.e., A.R.S. § 42-1310(2)(i)), the cost of solar energy devices is not an allowable deduction from the contractor's gross income. See also A.C.R.R. Rule R15-5-622, which provides, in part, that a contractor's cost of materials used in contracting are non-deductible.

Finally, to construe A.R.S. § 42-1312.01(A)(9) as applying to contractors, thereby creating a deduction not found in A.R.S. § 42-1310(2)(i) governing contractors, would result in the impermissible creation of a tax exemption by implication. Gietz v. Webster, 46 Ariz. 261, 50 P.2d 573 (1935); New Cornelia Co-operative Mercantile Co. v. Arizona State Tax Commission, 23 Ariz. App. 324, 533 P.2d 84 (1975).

The answer to your question, therefore, is that a contractor may not deduct the cost of a solar energy device from his contracting tax base pursuant to A.R.S. § 42-1312.01(A)(8). Please advise if you require additional information.

Sincerely,

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